Case No. D12/19

Salaries tax – whether salaries tax chargeable on bonus received – whether bonus paid for past service and performance – burden of proof to show otherwise – sections 8, 9 and 68 of the Inland Revenue Ordinance ('the Ordinance')

Panel: Wong Kwai Huen Albert (chairman), David Tai Wai Lai and Lee Tsung Wah Jonathan.

Date of hearing: 17 April 2019.
Date of decision: 3 September 2019.

The Appellant was terminated by his employer on the ground of redundancy in November 2015. After his departure, his employer paid him $900,000 as bonus in March 2016. The Assessor included the bonus in the Salaries Tax Assessment for the 2015/16 year of assessment. The Appellant appealed against the assessment, and argued that since the bonus was only paid after he was terminated, it was paid not for his employment, but as compensation 'for something else', or for certain issues for which his employer had to make such payment.

Held:

1. Pursuant to section 68(4) of the Ordinance, the Appellant carried the burden of proof to show that the bonus should not be subject to Salaries Tax Assessment. Therefore, it was up to the Appellant to produce evidence to prove that the bonus was paid for a particularly purpose, or the so called 'for something else' other than a reward for his service as an employee. It was not up to the Board to speculate any hidden agenda behind the payment of the bonus. (Commissioner of Inland Revenue v Common Empire Ltd (No.2) [2007] 3 HKLRD 75 followed).

2. Salaries tax is chargeable on payment received by an employee upon termination of his employment if the payment was made in return for acting as or being an employee, or as a reward for past services. Although the Appellant's employment was terminated before the payment date of the bonus, there was nothing extraordinary or abnormal for his employer to exercise its discretion to pay the Appellant the bonus for his service. It was perfectly legitimate for his employer to pay the Appellant a bonus for his past service and performance. (Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 applied; D87/01, IRBRD, vol 16, 725; D21/09, (2009-10) IRBRD, vol 24, 517 considered).

Appeal dismissed and costs order in the amount of $20,000 imposed.

Cases referred to:

Fuchs v Commissioner of Inland Revenue [2011] 14 HKCFAR 74
Commissioner of Inland Revenue v Common Empire Ltd (No.2) [2007] 3 HKLRD 75
D87/01, IRBRD, vol 16, 725
D21/09, (2009-10) IRBRD, vol 24, 517

The Appellant in person.
Chan Lok Ning Loraine and Ngan Sin Ling Fatima, for the Commissioner of Inland Revenue.

Decision:

Background

1. Mr A ('the Appellant') has objected to the Salaries Tax Assessment for the year of assessment 2015/16 raised on him. The Appellant claimed that certain payments made to him by his ex-employer upon termination of employment and the value of certain shares vested in him after termination of the employment should not be chargeable to Salaries Tax.

2. (a) By a letter dated 5 May 1987, Bank B offered to employ the Appellant with effect from 1 July 1987. The offer was accepted by the Appellant.

(b) By a letter dated 19 October 2012, Bank B confirmed that the Appellant's employment with it would cease and he would be employed by Bank C with effect from 1 January 2013.

3. According to the Respondent, by a letter dated 22 August 2013 ('the Contract'), Bank B confirmed that the Appellant's employment with Bank C would cease and he would be employed by Bank B with effect from 1 November 2013. The Contract contained, among others, the following terms and conditions:

Discretionary bonus scheme

(a) The Appellant was eligible to participate in the appropriate discretionary bonus scheme, as determined by Bank B, subject to the rules of such scheme established by Bank B. The amount of such bonus (if any) was determined at the sole discretion of Bank B which might take into consideration his performance, the

performance of Bank B Group ('the Group') and such other factors as Bank B might from time to time determine.

(b) Bonuses might be delivered in cash and/or deferred in the form of cash/shares, under the Bank B Share Plan 2011 ('the 2011 Share Plan'), at the sole discretion of Bank B. Cash bonuses, if any, would normally be paid by March of the following year. Again, according to the Respondent, to be eligible for any award, the Appellant must be in Bank B's employment on the distribution date, and not under notice either given to or received from Bank B. The Appellant took issue with the Respondent on this point, which would be further elaborated below.

(c) Right was reserved to review, revise, withdraw or substitute the discretionary bonus scheme at discretion.

Share plans

(d) The Appellant's participation in the Group's share plans would continue, if any. Arrangement would be made to transfer his existing share plans to Bank B, if the share plans were transferable.

Notice period

(e) The Appellant's employment could be terminated at any time by either party by giving three months' notice in writing or payment of wages in lieu after completing probation.

4. Under the 2011 Share Plan and Bank B International Employee Share Purchase Plan ('Share Plan D'), the eligible employees of Bank B were granted conditional rights to acquire shares of Company E. The plans contained, among others, the following terms for vesting of shares as a good leaver.

The 2011 Share Plan

(a) If a participant left the Group before the vesting date as a good leaver, subject to the approval, his share award would vest in full on the vesting date. Good leaver reasons included redundancy.

Share Plan D

(b) If a participant ceased employment before vesting as a good leaver, his share award would vest as soon as practicable on or following the date of cessation, or subject to the approval, continue to vest on the vesting date. Good leaver reasons included redundancy.

5. The Appellant was awarded the following restricted shares under the 2011

Share Plan:

	Award date	Total shares subject to award	% of award which would vest	Vesting date
(a)	11-03-2013	1,135	33	11-03-2014
			33	11-03-2015
			34	11-03-2016
(b)	10-03-2014	5,207	33	10-03-2015
			33	10-03-2016
			34	10-03-2017
(c)	02-03-2015	6,266	33	14-03-2016
			33	14-03-2017
			34	14-03-2018
(d)	29-02-2016	1,975	33	13-03-2017
			33	13-03-2018
			34	13-03-2019

6. By a letter dated 11 November 2015 ('the Termination Letter'), Bank B informed the Appellant that his employment would be terminated on the ground of redundancy. The Termination Letter contained, among others, the following terms:

(a) The Appellant's last working date and termination date with Bank B would be 11 November 2015. The termination of his employment would take effect from 12 November 2015.

(b) According to the Contract, Bank B would make payment in lieu of three months' notice.

(c) 'As [the Appellant's] employment is terminated on the grounds of redundancy, subject to the terms of this letter and [the Appellant's] returning a signed copy of this letter, [Bank B] proposes to pay [the Appellant] a severance payment of HKD2,600,004 ("the Severance Payment") which is inclusive of and in excess of the statutory severance payment required under law.

By accepting the severance payment, [the Appellant] confirm[s] that the terms of this letter are in full and final settlement of the termination of [his] employment. [The Appellant] also confirm[s] that [he does] not have any claims, and will not bring any claim or case, against [Bank B] and/or any other Group Company … in connection with [his] employment by [Bank B] and the termination of [his] employment.'

If the Appellant did not accept the terms of the Termination Letter, he would only be entitled to a statutory severance payment.

(d) Subject to the acceptance of the Termination Letter and the approval of the Remuneration Committee, the Appellant would be treated as a good leaver under the Bank B share plans. Any unvested awards including restricted share awards which had been awarded to the Appellant would continue to be subject to the rules of the share plans and would vest in accordance with normal procedures, notwithstanding that he would not be in employment on the vesting dates.

The Appellant signified acceptance of the terms of the Termination Letter on 13 November 2015.

7. On 13 November 2015, the Appellant signed an acknowledgment receipt acknowledging that the final payment would be in full and final settlement of all claims whatsoever, whether past, present or future, arising out of or in connection with his employment with Bank B. The final payment was calculated as follows:

		Amount $	
(a)	Final month's base salary	79,444.57	
(b)	Final month's allowance	6,111.23	
(c)	The Severance Payment	2,600,004	
(d)	Ex-gratia payment	3,069,449.17	
(e)	Payment in lieu of annual leave	148,485.27	
(f)	Payment in lieu of notice (from 12-11-2015 to 11-02-2016: $233,334 x 3)	700,002	('Sum A')
		6,603,496.24	

8. (a) On divers dates, Bank B filed notifications by an employer of an employee who was about to cease to be employed ('IR56F') in respect of the Appellant reporting the following particulars:

		First	Second	Third	Fourth	Fifth	Sixth
Capacity in which employed	:	Position F					
Date of cessation of employment	:	12-11-2015					
Period of employment	:	01-04-2015 – 11-11-2015					
Reason for cessation	:	Redundancy					
Income particulars –	:	$	$	$	$	$	$
Salary		1,718,893	1,718,893	1,718,893	1,718,893	1,718,893	1,718,893
Leave pay		148,485	148,485	148,485	148,485	148,485	148,485
Payment in lieu of notice (Sum A)		700,002	700,002	700,002	700,002	700,002	700,002
Share option gain		29,616	29,616	29,616	29,616	29,616	29,616
Other allowances or perquisites		-	26,970	44,948	1,202,107	1,566,887	1,823,165
		2,596,996	2,623,966	2,641,944	3,799,103	4,163,883	4,420,161

Note

The sixth IR56F was a replacement of the first IR56F to fifth IR56F.

(i) The other allowances or perquisites of $1,823,165 in the sixth IR56F consisted of the following items:

	$	
The Bonus	900,000	('Sum B')
Education benefits	71,915	
Restricted shares released	832,813	(collectively known
Share Plan D released	18,437	as 'Sum C')
	1,823,165	

(ii) Details of the restricted shares released to the Appellant were as follows:

Award date	Release date	No. of shares released	Market price on release date	Value of restricted shares
			$	$
11-03-2013	11-03-2016	453	50.30	22,785
10-03-2014	10-03-2016	2,015	50.20	101,153
10-03-2014	10-03-2017	2,127	63.00	134,001
02-03-2015	14-03-2016	2,264	50.70	114,784
02-03-2015	14-03-2017	2,479	63.50	157,416
02-03-2015	14-03-2018	2,573	76.50	196,834
29-02-2016	13-03-2017	721	64.35	46,396
29-02-2016	13-03-2018	771	77.10	59,444
				832,813

(iii) Details of Share Plan D released to the Appellant were as follows:

Grant date	Release date	No. of shares released	Market price on release date	Value of the Share Plan D
			$	$
09-09-2013	02-12-2015	114.2398	62.85	7,179
03-09-2014	02-12-2015	179.1335	62.85	11,258
				18,437

(b) Bank B also informed the Respondent that, in addition to the income reported in the IR56F, the Appellant was made the Severance Payment and ex-gratia payment of $3,069,449.17 ('the Ex-gratia Payment') in compensation for the involuntary loss of employment with Bank B due to redundancy.

9. The Appellant filed his Tax Return – Individuals for the year of assessment 2015/16 and declared income of $2,641,944 and a bonus of $900,000 derived from Bank B for the periods from 1 April 2015 to 11 November 2015 and 1 April 2015 to 31 March 2016 respectively. A copy of the payroll statement for March 2016 issued by Bank B to the Appellant was attached to his tax return.

10. The Respondent accepted that the Severance Payment and the Ex-gratia Payment were not taxable. Based on the fourth IR56F, the Respondent raised on the Appellant the following Salaries Tax Assessment for the year of assessment 2015/16:

	$
Income	3,799,103
Less: Self-education expenses	5,000
Net Assessable Income	3,794,103
Less: Personal allowances	400,000
Net Chargeable Income	3,394,103
Tax Payable thereon (after tax reduction)	544,997

11. The Appellant objected to the above assessment on the grounds that the payment in lieu of notice (i.e. Sum A) and the discretionary bonus payment, which included cash bonus (i.e. Sum B) and shares awarded to be vested in three years (i.e. Sum C) should not be taxable.

12. Despite the Appellant's objection, in its Determination dated 1 November 2018 ('the Determination'), the Respondent maintained its view that Sum A, Sum B and Sum C should be taxable. Based on the sixth IR56F, the Respondent considered that the Salaries Tax Assessment for the year of assessment 2015/16 should be as follows:

	$
Income	4,420,161
Less: Self-education expenses	5,000
Net Assessable Income	4,415,161
Tax Payable thereon (at standard rate and after tax reduction)	642,274

The Issue

13. At the hearing, the Appellant confirmed to the Board that despite that the Determination dealt with Sum A, Sum B and Sum C, his appeal to this Board would be narrowed down to that of Sum B only i.e. $900,000 as mentioned in paragraph 8(a)(i) above.

14. The only issue the Board has to decide now is whether Sum B paid by Bank B to the Appellant should be chargeable to Salaries Tax.

The Law

15. The Respondent has referred the Board to various sections in the Inland Revenue Ordinance ('IRO') and relevant case law. The Board finds the following references particularly relevant to this appeal:

Statutory Provisions

(1) Section 8 of the IRO

'*(1) Salaries tax shall, subject to the provisions of [the IRO], be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from the following sources-*

(a) any office or employment of profit …'

(2) Section 9 of the IRO

'*(1) Income from any office or employment includes-*

(a) any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others …'

(3) Section 68 of the IRO

'*(4) The onus of proving that the assessment appealed against is excessive or incorrect shall be on the appellant.*'

Relevant Cases

(4) In considering whether a payment received by an employee upon termination of his employment is taxable, the applicable principles were established in the Court of Final Appeal case Fuchs v Commissioner of Inland Revenue [2011] 14 HKCFAR 74 ('Fuchs case'). Ribeiro PJ stated the following:

'*… Income chargeable under [section 8(1) of the IRO] is likewise not confined to income earned in the course of employment but embraces payments made … "in return for acting as or being an employee", or … "as a reward for past services or as an inducement to enter into employment and provide future services*'…

'*It is worth emphasizing that a payment which one concludes is "for something else" and thus not assessable, must be a payment which*

does not come within the test … Thus, where a payment falls within the test, it is assessable and the fact that, as a matter of language, it may also be possible to describe the purpose of that payment in some other terms, eg, as "compensation for loss of office", does not displace liability to tax. The applicable test gives effect to the statutory language and other possible characterisations of the payment are beside the point if, applying the test, the payment is "from employment".'

(5) On the issue of the burden of proof, in Commissioner of Inland Revenue v Common Empire Ltd (No.2) [2007] 3 HKLRD 75 ('Common Empire case'). Deputy Judge Anthony To stated the following:

'*…But in respect of appeals against the determination of the Commissioner, s. 68(4) provides that the burden is borne by the taxpayer throughout the entire proceeding. The Commissioner, or the assessor who attends on his behalf, has no burden of proving anything. He can simply rely on the assessment as correct. It is for the taxpayer to prove that it is not by showing that the reasons relied on by the Commissioner in affirming the assessment is wrong as a matter of law or that the facts upon which the determination was made was factually incorrect. If the taxpayer calls no evidence on any disputed facts, or if he has given evidence but is disbelieved, the Board shall determine the appeal on the basis of the material before it, ie the Commissioner's reasons for his determination and his statement of facts.* '

(6) In the Board Decision D87/01, IRBRD, vol 16, 725, a taxpayer was laid off by a company with immediate effect. Apart from the severance payment and payment in lieu of notice, the company paid him an 'extra one month' payment and the taxpayer claimed that it was part of the severance payment. The Board dismissed the appeal and held that the 'extra one month' payment was not a severance payment, contractual payment, statutory payment or payment for loss of employment rights. The company had already fulfilled every contractual and statutory duty in making severance pay to the taxpayer. It was a payment for something 'extra' and clearly arose from the employment.

(7) In the Board Decision D21/09, (2009-10) IRBRD, vol 24, 517, a taxpayer claimed that a discretionary bonus paid to her by a company upon termination of her employment was a compensation for her loss of employment. Since she held a senior position, it was inevitable that there must have been a payment for her to remain quiet and not to institute proceedings against the company for wrongful dismissal. The Board held that the sum the taxpayer

received was in a nature of an award for her past services and thus income from her employment. There was no evidence at all to show that the company was in breach of its contractual obligations that she would be entitled to receive any compensation, and the taxpayer surrendered any rights in consideration for accepting the sum.

The Appellant's Case

16. (a) The Board finds the Appellant's grounds of appeal as summarized by the Respondent to be useful:

(i) Sum B did not comply with the terms provided under the 'Discretionary Bonus Scheme' in the Contract since at the time of bonus distribution he was no longer in Bank B's employment. The Appellant had never acknowledged such a payment to be his employment related payment. That being the case, he should not be assessed on a sum which Bank B chose to credit to his account without his acknowledgement on the nature of payment.

(ii) The Termination Letter did not mention anything about 'approved bonus' or similar payment. All parties must be legally bound by the terms of the final settlement including 'the legal or tax impact' as stated in the Termination Letter. The fact that Bank B did not explain why an extra payment i.e. Sum B was made to him after all his entitlements upon termination of employment having been fully settled, suggested that Sum B must be 'compensation for certain issues' which Bank B had to pay him.

(iii) The redundancy decision must be well planned by Bank B. One should question about why the approval on 'bonus' was obtained on 12 November 2015, which was one day after the redundancy meeting instead of before.

(iv) The 'approval system printout' did not show that it was related to his bonus approval. It might in fact be his redundancy decision approval. One should question about whether someone was acting ultra vires in the process or was hiding certain facts. The Respondent had no basis to accept Bank B's 'unilateral explanation' that such document was related to the approval of his bonus. The Respondent had never tried to clarify or seek input from the Appellant.

(v) As a member of the senior management staff, the Appellant was bound by 'professional insider information privilege' that

he could not disclose full details of his argument with his employer.

(vi) The burden of proof should not be on an employee given all the 'peculiar and unusual facts' on the manner his redundancy was being handled.

(b) By a letter dated 25 March 2019, the Appellant further put forth his argument that Bank B had no intention to pay him the discretionary variable sum and Sum B was an ex-gratia payment made by Bank B subsequent to the final settlement. In support of his argument, the Appellant provided copies of a sample redundancy letter issued by Bank G, which included the clause of variable compensation eligibility against the redundancy letter issued by Bank B, which did not include such a clause.

Finding

17. The Board finds it necessary to deal with the legal point of burden of proof at the outset.

18. As mentioned in paragraph 15(3) above, Section 68 of the IRO states clearly that the onus of proving that the assessment appealed against is excessive or incorrect shall be on the Appellant. The Inland Revenue Department ('the IRD') does not have the burden of proving anything. At the hearing, the Respondent can simply rely on the assessment being correct. This principle has been clearly explained in the Common Empire case.

19. In this appeal, the Appellant raised a host of queries about the nature of Sum B, the manner and the date of its payment; presumably to support his argument that Sum B was not 'income from employment' and therefore not taxable. However, most of these queries stemmed from the internal management and administrative procedures of Bank B upon the termination of employment of its staff. None of them could be or should be answered by the Respondent, least of all, by the Board. The Appellant must adduce direct evidence to support his contentions. As will be explained below, the Board can find no 'peculiar or unusual facts' which would relief the Appellant's burden of proof.

20. The test whether a payment received by an employee upon or after the termination of his employment is stated in the Fuchs case. In summary, if a sum is in substance income from employment which is paid 'in return for acting as or being an employee; as a reward for past services or as an inducement to enter into employment and provide future services', the sum is taxable. If the sum is not made pursuant to any entitlement under the employment contract but is made 'for something else', such as a consideration for an employee agreeing to surrender or forgo his pre-existing contractual rights, the sum is not taxable.

21. To reduce the Appellant's argument to its bare bones, he was simply saying that whilst he was quite prepared to accept the payment of Sum B, he had never acknowledged its nature. Given that Bank B had no legal obligation to pay him more than what they had already done upon his departure, this sum had to be 'for something else', or 'compensation for certain issues' for which Bank B had to pay him.

22. The Board has found it difficult to follow the above argument. This is especially so when the Appellant failed to elaborate on what these 'something else' and 'certain issues' were about. Despite the allegations stated in his Grounds of Appeal of certain confidential information regarding 'heated discussions among [Bank B]'s top management' and 'professional insider information privilege', the Appellant confirmed at the hearing that Sum B was not a payment or reward for him to keep confidential any information regarding his employer. The Appellant alluded to certain 'unsettlement' or 'stir' among his old colleagues upon his departure from Bank B. However, such allegations were all too vague and flimsy and unsupported by evidence. They could not constitute sufficient grounds for Sum B to be considered as a payment 'for something else' as stated in the Fuchs case.

23. The Appellant made references to Bank B's internal administrative procedures of making 'its usually well-planned redundancy decisions' and invited the Board to query why in the case of the approval of Sum B, it was obtained one day after the date of the Termination Letter. The Board did not find anything untoward in this delay of one day in the whole process.

24. The Appellant also referred the Board to a document appeared to be a proposal from seeking approval of the Appellant's 'good leaver status' and argued that the document was in fact the approval of his redundancy decision and that someone was acting ultra vires and hiding certain facts. The Board cannot find any relevance of such allegations. In any event, there was no evidence to support them.

25. As already mentioned above, neither the Respondent nor the Board is in a position to query Bank B's procedural steps in obtaining an approval or to speculate any hidden agenda behind the payment of Sum B. Any allegations of irregularities, abnormalities, mismanagement and act of ultra vires on the part of anyone within Bank B was neither here nor there in this appeal. It is up to the Appellant to produce evidence to prove that Sum B was paid for a particular purpose or the so called 'for something else' other than a reward for his service. There is simply no such evidence.

26. The Board also finds that the Appellant's reference to a letter of another bank relating to its approval procedures and payment of variable compensation in similar redundancy situations is totally irrelevant. Different banks will most certainly adopt different administrative procedures. There is nothing to compare. Similarly, the Appellant's allegations of procedural injustice by the Respondent's unilaterally reaching out to Bank B seeking information and his worry about the possibility of the Respondent contacting members of this Board are utterly absurd. Such insinuations and allegations are unfounded and unwarranted. They do not assist the Appellant's case in any way whatsoever.

27. The nature of Sum B should be determined by taking into consideration all the circumstances of its payment. The Appellant's acknowledgement of its nature, or the lack of it, was quite beside the point. Although the Appellant's employment with Bank B was terminated before the payment date of bonus for the year 2015, there was nothing extraordinary or abnormal for Bank B, as an employer or ex-employer, to exercise its discretion to pay the Appellant Sum B for his service in the year 2015. Any slight delay in the approval process and the deferment of the payment did not affect the legitimacy of Sum B. In fact, the payment of Sum B was effected on 23 March 2016, which was around the same time when Bank B paid its other employees the discretionary bonus for the year 2015.

28. In any case, according to the Appellant's payroll statement for the month of March 2016 and Bank B's confirmation, Sum B was a bonus paid to the Appellant due to his good performance during his service in the bank. There is no reason why Bank B's confirmation should not be accepted by the Respondent as being conclusive. The Board finds that it was perfectly legitimate for Bank B to pay the Appellant a bonus for his past service and performance under the circumstances. It followed that Sum B was the Appellant's income from employment with Bank B and should be chargeable to Salaries Tax.

29. The Board finds that the Appellant has failed to discharge the onus of proving that the Salaries Tax assessment on Sum B is excessive or incorrect. This appeal is dismissed.

30. Pursuant to Section 68(9) of the IRO, the Appellant is ordered to pay costs of the Board in the sum of $20,000.